

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION
OF
FLAXTON FARMERS MUTUAL
FIRE INSURANCE COMPANY
BOWBELLS, NORTH DAKOTA**

**AS OF
DECEMBER 31, 1996**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Flaxton Farmers Mutual Fire Insurance Company

Bowbells, North Dakota

as of December 31, 1996, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official
seal at my office in the City of
Bismarck, this _____ day of
_____, 1997.

Glenn Pomeroy
Commissioner of Insurance

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Bowbells, North Dakota
August 25, 1997

Honorable Glenn Pomeroy
Commissioner of Insurance
State of North Dakota
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners, an examination was made of the books, records, and financial condition of

Flaxton Farmers Mutual Fire Insurance Company

Bowbells, North Dakota

as of December 31, 1996.

INTRODUCTION

Flaxton Farmers Mutual Fire Insurance Company, Bowbells, North Dakota, hereinafter referred to as the "Company," was last examined as of December 31, 1991, by representatives of the State of North Dakota.

SCOPE OF EXAMINATION

The current examination covers the period January 1, 1992, through December 31, 1996, including any material transactions and events occurring subsequent to the examination date and noted during the course of this examination.

This examination was made in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners with due regard to the statutory requirements of the insurance laws, rules, and regulations of the State of North Dakota.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and review of corporate records, claim files, and other records relating to Company operational practices.

HISTORY

The Company was incorporated on February 6, 1906, as "The Flaxton Farmers Mutual Fire Insurance Company of Ward County" and commenced business on June 10, 1906.

At the annual meeting of policyholders, held on July 19, 1975, the Articles of Incorporation were officially amended, changing the name of the Company to "Flaxton Farmers Mutual Fire Insurance Company."

The Company's term of existence was originally established for 30 years. The Articles and Bylaws were subsequently amended in accordance with N.D.C.C. § 26.1-13-03 making the Company's existence perpetual.

The Company was organized for the specific purpose of mutually insuring the property of its members against any risk of hazard by fire and lightning. During 1963, the Company extended its coverage to include the perils of windstorm, hail, explosion, aircraft or vehicles, smoke, riot, theft of personal property, injury or death of livestock, overturn or collision of farm machinery, vandalism or malicious mischief, and additional living expenses.

MANAGEMENT AND CONTROL

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges accorded each member. No person who does not reside within such territorial limits shall become a director of the Company.

Directors

The management of the Company's affairs, business, and property is vested in a Board of Directors composed of eight members elected for staggered terms of three years each at the annual meeting of the membership. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 1996, were as follows:

Name and Residence	Term Expires
Kerry Strom Portal, ND	1999
Bruce Anderson Bowbells, ND	1998
Richard Hinds Bowbells, ND	1998
Arthur Glasoe Wildrose, ND	1997
Wayne Christensen Flaxton, ND	1997
Floyd Nelson Flaxton, ND	1999
Jim Iverson Columbus, ND	1997
Donald Benge Flaxton, ND	1999

Officers

Officers are elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting. Officers serving at December 31, 1996, were as follows:

<u>Name</u>	<u>Office</u>
Kerry Strom	President
Richard Hinds	Vice President
Bruce Anderson	Secretary and Treasurer

CORPORATE RECORDS

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

It was noted that Article 6 of the Articles of Incorporation states the Company operates on a fiscal year beginning September 1. **It is recommended that this Article be amended to conform with the Company's current calendar year basis of operations.**

Members

During the period under examination the annual meetings of the policyholders were held on the following dates: June 3, 1992; June 2, 1993; June 1, 1994; June 7, 1995; and June 6, 1996.

Directors

During the period under examination the Board of Directors held six regular meetings in 1992; five in 1993, 1994, 1995, and 1996. One special meeting was held in 1993 and 1994.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 1996, there was in force a continuous position schedule fidelity bond covering the Secretary-Treasurer and the President for the faithful performance of duty in the amount of \$25,000 each. The coverage meets the minimum amount of fidelity insurance recommended in the NAIC's *Financial Examiners Handbook* which is \$25,000.

The Company also had in force a directors and officers liability insurance policy providing a \$1,000,000 limit of liability each policy year. Each claim is subject to a \$2,500 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

The Company does not carry insurance on its furniture, fixtures, records, and files against insurable hazards.

TERRITORY AND PLAN OF OPERATION

At December 31, 1996, the Company had 23 licensed agents and was authorized to transact business within the following counties:

Bottineau	Burke	Divide	McHenry	McKenzie
McLean	Mercer	Mountrail	Nelson	Renville
Sheridan	Ward	Williams		

SIGNIFICANT OPERATING RESULTS

Growth

The following exhibit reflects the growth of the Company over the five-year period under examination. Data with respect to the years 1992 through 1995 is as compiled from home office copies of the filed Annual Statements. Data for the year 1996 reflects the results of this examination. The operational results are presented on a cash basis.

Year	Admitted Assets	Total Liabilities	Surplus as Regards Policy-holders	Net Premiums Written	Under-writing Deductions	Investment and Other Income	Net Income (Loss)
1992	\$547,179	\$119,164	\$428,015	\$101,662	\$110,469	\$13,522	\$ 4,715
1993	652,012	110,756	541,256	148,980	102,879	58,571	104,672
1994	703,617	124,390	579,227	170,339	136,922	39,298	72,715
1995	757,328	143,728	613,600	182,246	198,161	40,899	24,983
1996	771,402	168,894	602,508	197,163	172,668	47,944	72,438

Operating Ratios

The underwriting ratios presented below are on a cash basis and encompass the five-year period ending December 31, 1996.

	1992	1993	1994	1995	1996
Premiums	100%	100%	100%	100%	100%
Deductions:					
Losses and Loss Adjustment	40.9%	17.3%	35.0%	63.4%	41.3%
Underwriting Expenses	67.8%	51.8%	45.3%	45.3%	46.3%
Total Deductions	108.7%	69.1%	80.3%	108.7%	87.6%
Net Underwriting Gain (Loss)	-8.7%	30.9%	19.7%	-8.7%	12.4%

MARKET CONDUCT ACTIVITY

Treatment of Policyholders

Claims From an examination of claim files, the Company appears to pay claims fairly within policy provisions upon receipt of satisfactory proof of loss or damage.

Advertising The advertising material was reviewed and none appeared to be deceptive.

REINSURANCE

The Company ceded reinsurance under a reinsurance treaty with Grinnell Mutual Reinsurance Company during the years under examination; this nonaffiliated ceding contract consists of individual occurrence of loss and aggregate excess as summarized below. The contract contained all the required clauses including the insolvency clause required by N.D.C.C. § 26.1-02-21.

Type: Excess

Reinsurer: Grinnell Mutual Reinsurance Company

Scope:	Fire, Lightning and Extended Coverage:								
	(A) Individual Occurrence of Loss Excess - covers all risks written by the Company in excess of a \$30,000 retention subject to the following limits:								
	<table> <tr> <td>Dwellings</td><td>\$ 500,000</td></tr> <tr> <td>Farm Outbuildings</td><td>500,000</td></tr> <tr> <td>Livestock Confinements</td><td>250,000</td></tr> <tr> <td>Commercial and Public Property</td><td>250,000</td></tr> </table>	Dwellings	\$ 500,000	Farm Outbuildings	500,000	Livestock Confinements	250,000	Commercial and Public Property	250,000
Dwellings	\$ 500,000								
Farm Outbuildings	500,000								
Livestock Confinements	250,000								
Commercial and Public Property	250,000								
	(B) Aggregate Excess - provides coverage for 100 percent of the Company's aggregate net loss in excess of a defined retention limit. The retention limit for 1996 was \$119,901.								
Premium:	(A) Individual Occurrence of Loss Excess - The 1996 annual premium was \$.4524 per \$1,000 of adjusted gross fire risks In force at the end of each month during the contract year.								
	(B) Aggregate Excess - The 1996 annual premium was \$.23 per \$1,000 of gross fire risks in force at the end of each month during the contract year.								
Commissions:	None								
Termination Date:	The agreement may be terminated only as of the last day of any calendar year by either party upon 90 days notice in writing.								

ACCOUNTS AND RECORDS

The accounts and records of the Company are on a cash basis and consist of a cash receipts journal, a cash disbursement journal, a claims register, check and voucher records, and a corporate record book.

A trial balance was prepared as of December 31, 1996, for the purpose of tracing it to the Annual Statement with no differences noted.

FINANCIAL STATEMENTS

The following statements reflect the financial condition of the Company as of December 31, 1996, as determined by this examination and its operating results for the year then ended.

Flaxton Farmers Mutual Fire Insurance Company
Assets, Liabilities, and Surplus
as of December 31, 1996

ASSETS

LEDGER ASSETS:

Bonds	\$150,662.63
Stocks	359,153.86
Checking Account	11,606.48
Cash on Deposit	<u>294,298.10</u>

TOTAL LEDGER ASSETS \$815,721.07

NONLEDGER ASSETS:

Interest Due and Accrued on CDS, Savings	\$ 9,161.45
Furniture and Fixtures	<u>28.74</u>

TOTAL NONLEDGER ASSETS 9,190.19

DEDUCT: ASSETS NOT ADMITTED

Furniture and Fixtures	\$ 28.74
Excess of Book Value Over Market Value	8,480.36
Bond in Default	<u>45,000.00</u>

TOTAL NONADMITTED ASSETS 53,509.10

TOTAL NET ADMITTED ASSETS \$771,402.16

LIABILITIES

Unpaid Losses	\$ 23,000.00
Unpaid Loss Adjustment Expenses	500.00
Unearned Premium	134,365.06
Commissions Payable	3,362.74
Unpaid Taxes	1,049.00
Unpaid General Expenses	182.00
Reinsurance Premiums Due and Payable	<u>6,434.86</u>

TOTAL LIABILITIES \$168,893.66

SURPLUS TO POLICYHOLDERS 602,508.50

TOTAL LIABILITIES AND SURPLUS \$771,402.16

Flaxton Farmers Mutual Fire Insurance Company
Statement of Income and Disbursements (Cash Basis)
for the Year Ending December 31, 1996

INCOME		
Gross Premium Income	\$254,131.23	
Less: Return Premiums	1,508.55	
Premiums for Reinsurance Ceded	<u>55,459.87</u>	
NET PREMIUM INCOME		\$197,162.81
Interest on Bonds	15,851.60	
Dividends on Stocks	6,983.39	
Interest on Cash on Deposit	20,969.26	
Commissions From Grinnell	<u>4,139.30</u>	
TOTAL INCOME RECEIPTS		\$245,106.36
DISBURSEMENTS		
Gross Losses Paid and Incurred in 1996	\$ 69,239.27	
Gross Losses Paid in 1996 But Incurred in Prior Years	20,302.78	
Deduct: Reinsurance Recovered	<u>9,222.29</u>	
NET LOSSES PAID		\$ 80,319.76
Claim Adjustment Expenses	1,092.83	
Commissions Paid to Agents	41,400.04	
Directors Fees and Expenses	1,289.05	
Salaries to Employees	25,737.00	
Printing, Stationary, and Office Supplies	609.09	
Rent and Rent Items (Including \$1,800 for Company Occupancy)	1,800.00	
VISA Fee	9.00	
State and Local Insurance Taxes	4,393.00	
Insurance Department Licenses and Fees	425.00	
Payroll Taxes	2,224.79	
Legal Fees and Auditing	33.60	
Travel and Travel Items	1,514.90	
Advertising	957.60	
Dues and Donations	969.00	
Insurance and Bonds	1,693.00	
Postage, Telephone, and Bank Charges	2,315.26	
Employee Relations and Welfare	5,421.50	
Meeting Expense	377.56	
Merrill Lynch Management Fee	<u>86.10</u>	
TOTAL FUNDS DISBURSED		<u>172,668.08</u>
NET INCOME (LOSS)		<u>\$ 72,438.28</u>

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 1996, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Bonds

\$150,662.63

The following schedule presents the classification, par value, book value, and admitted value of all bonds owned by the Company as of December 31, 1996:

Classification	Market Value	Actual Cost	Par Value	Admitted and Investment Value
U.S. Government	\$111,147.00	\$ 79,999.89	\$244,000.00	\$105,662.63
General Obligation		45,000.00	45,000.00	
TOTALS	\$111,147.00	\$124,999.89	\$289,000.00	\$105,662.63

Market values were determined on the basis of methods established by the Committee on Valuation of Securities of the NAIC. The investment or admitted value of bonds at December 31, 1996, represents book value except for the general obligation bond that is in default of principal and interest. The bond in default was issued by International Trade Fund Ltd. Liability Company. In its Annual Statement, the Company valued this bond using a book value of \$45,000. However, the admitted value of a bond in default is its current market value as determined by the Securities Valuation Office (SVO) of the NAIC. The Company failed to submit the bond for valuation with the SVO as required by N.D.C.C. § 26.1-03-02.1. Therefore, the Examiner has classified the bond in default as a nonadmitted asset in accordance with NAIC guidance.

Three mutual funds having an aggregate book value of \$150,871.69 and admitted value of \$141,767.09 were reclassified as stocks by the Examiner. In addition to the bond in default and a money market fund, the Company also failed to submit these mutual fund investments for valuation with the SVO in violation of N.D.C.C. § 26.1-03-02.1. **It is recommended that all unlisted securities be submitted for valuation with the SVO in accordance with the procedures set forth in the *Purposes and Procedures of the SVO of the NAIC*.**

The decrease in this caption is reflected in the changes to "Surplus to Policyholders" of this report.

Stocks**\$359,153.86**

The following schedule discloses the classification, number of shares, cost and book value, and market or admitted value of all shares owned at year end:

Classification	Number of Shares	Cost and Book Value	Market and Admitted Value
Stock Funds: Insurance	30.00	\$ 1,500.00	\$ 3,227.40
Money Market	105,461.01	105,461.01	105,461.01
Mutual Fund	22,232.41	252,192.83	241,985.09
TOTALS	127,723.42	\$359,153.86	\$350,673.50

The admitted value of the stocks was determined using unit prices established by the Committee on Valuation of Securities or by methods set forth in the *Purposes and Procedures of the Securities Valuation Office of the NAIC*.

In its 1996 Annual Statement, the Company incorrectly classified three mutual funds as bonds and a money market fund as cash. For the purpose of this report, the Examiner properly reclassified those investments as stocks. **It is recommended that all mutual funds and money market funds be classified as stocks.**

The admitted value of stock was determined to be in the amount of \$359,153.86 or \$245,373.54 more than that reported by the Company. The increase in this caption is reflected in the changes to "Surplus to Policyholders" of this report. The excess of book value over market value of \$8,480.36 is treated as a nonadmitted asset.

Cash on Deposit**\$294,298.10**

Cash on deposit consisted of the following item and amount at December 31, 1996:

Certificates of Deposit	\$294,298.10
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In its 1996 Annual Statement, the Company incorrectly classified an investment in a money market fund as cash. In accordance with instructions set forth by the NAIC, the Examiner properly reclassified the money market fund as stocks. The decrease in this caption is reflected in the changes to "Surplus to Policyholders" of this report.

Market Value of Stocks Over Book Value**\$0**

Comments relating to the above have been made under the "Stocks" caption of this report. The decrease in this caption is reflected in the changes to "Surplus to Policyholders" of this report.

Excess of Book Value Over Market Value**\$8,480.36**

Comments relating to the above have been made under the "Stocks" caption of this report. The increase in this caption is reflected in the changes to "Surplus to Policyholders" of this report.

Bond in Default**\$45,000.00**

Comments relating to the above have been made under the "Bonds" caption of this report. The increase in this caption is reflected in the changes to "Surplus to Policyholders" of this report.

Unpaid Losses**\$23,000.00**

The Company's liability for unpaid losses at year end was determined by this examination to be in the amount of \$23,000 or \$10,000 more than that estimated by the Company. The increase is reflected in the changes to "Surplus to Policyholders" of this report.

Unpaid Loss Adjustment Expenses**\$500.00**

The Company's liability for unpaid loss adjustment expenses at year end was determined by this examination to be in the amount of \$500 or \$350 more than that estimated by the Company. The increase is reflected in the changes to "Surplus to Policyholders" of this report.

Unpaid Taxes**\$1,049.00**

The Company's liability for unpaid taxes at year end was determined by this examination to be in the amount of \$1,049 or \$111 less than that reported by the Company. The difference is due to the calculation of the Company's ad valorem credit. During the period under review, the Company did not take an ad valorem tax credit. For purposes of the credit, the Company may claim a portion of real estate tax on the space occupied as a home office in proportion to the total space of the building.

The decrease in the captioned liability is reflected in the changes to "Surplus to Policyholders" of this report.

Unpaid General Expenses**\$182.00**

Invoices and other evidence of indebtedness were reviewed for expenses incurred prior to year end but paid subsequent to year end. The liability for unpaid general expenses was determined by this examination to be in the amount of \$182 or \$50 more than that reported by the Company. The increase is reflected in the changes to "Surplus to Policyholders" of this report.

Surplus to Policyholders**\$602,508.50**

Surplus to policyholders was determined by this examination to be in the amount of \$602,508.50 or \$64,393.60 less than the amount reported by the Company. Adjustments to surplus are shown in the following schedule:

Caption	Company	Examination	Increase or (Decrease)
Ledger Assets			
Bonds	\$301,534.32	\$150,662.63	\$(150,871.69)
Stocks	113,780.32	359,153.86	245,373.54
Cash on Deposit	388,799.95	294,298.10	(94,501.85)
Non-Ledger Assets			
Market Value of Stocks Over Book Value	624.24		(624.24)
Non-Admitted Assets			
Excess of Book Value Over Market Value		8,480.36	(8,480.36)
Bond in Default		45,000.00	(45,000.00)
Liabilities			
Unpaid Losses	13,000.00	23,000.00	(10,000.00)
Unpaid Loss Adjustment Expenses	150.00	500.00	(350.00)
Unpaid Taxes	1,160.00	1,049.00	111.00
Unpaid General Expenses	132.00	182.00	(50.00)
Net Change			\$ (64,393.60)

CONCLUSION

The financial condition of Flaxton Farmers Mutual Fire Insurance Company, Bowbells, North Dakota, as determined by this examination as of December 31, 1996, is summarized as follows:

TOTAL ADMITTED ASSETS	<u>\$771,402.16</u>
Total Liabilities	\$168,893.66
Surplus to Policyholders	<u>602,508.50</u>
TOTAL LIABILITIES AND SURPLUS	<u>\$771,402.16</u>

The Examiner expresses her appreciation for the courteous cooperation extended her during the course of this examination.

Respectfully submitted,

Diane Shervey, CPA, AFE
Examiner
N.D. Insurance Department

COMMENTS AND RECOMMENDATIONS

Since the last examination, conducted as of December 31, 1991, the Company's admitted assets have increased \$228,953.32 (42 percent), its total liabilities have increased \$60,276.87 (55 percent), and its surplus to policyholders has increased \$168,676.45 (39 percent).

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|---------|--|
| Page 3 | It is recommended that the Company amend Article 6 of the Articles of Incorporation to conform with the Company's current calendar year basis of operations. |
| Page 9 | Three mutual funds, one money market fund, and the bond in default owned by the Company at December 31, 1996, were not valued by the Securities Valuation Office of the NAIC as required by N.D.C.C. § 26.1-03-02.1. It is recommended that all unlisted securities be submitted for valuation with the Securities Valuation Office of the NAIC. |
| Page 10 | It is recommended that all mutual funds and money market funds be classified as stocks. |